UNITED STATES OF AMERICA
BEFORE THE
FEDERAL TRADE COMMISSION

V010003—Comments of Strategic Energy L.L.C.
Regarding Retail Electricity Competition

Pursuant to the March 6, 2001, Notice Requesting Comments on Retail Electricity Competition Plans issued by the Federal Trade Commission, Strategic Energy L.L.C ("Strategic Energy") hereby submits its response to a particular question raised in the Commission notice. Strategic Energy has participated in competitive electricity markets as a supplier since the first pilot program in New Hampshire in 1996, and we have extensive experience relating to most of the FTC's questions (We currently serve customers in Pennsylvania, California, New York and Ohio).

Strategic Energy is supporting comments filed by the Alliance for Retail Energy Markets ("AReM")[1] and responding to one issue that we consider to be of such significance that it far overshadows most other issues, and that is the issue of adequate generator capacity. Regions that use Installed Capacity Credits markets have implemented a market construct that presents the greatest threat to retail competition in the electricity industry.

Strategic Energy wishes to applaud the Commission for its issuance of the March 6 Notice. The advent of true retail competition has the potential to bring substantial benefits to electricity consumers throughout the nation. We hope you find our comments useful, and we

[1] The members of AReM serve most of the 150,000 California customers who have chosen a competitive electric provider. AReM's members include AES NewEnergy, Inc.; Commonwealth Energy Corp.; Enron Energy Services, Inc.; Green Mountain Energy Company; The New Power Company; Shell Energy Services; and Strategic Energy, L.L.C.

hope our suggestion to use Directed ICAP payments to encourage new generation can be implemented. If the FTC is interested, Strategic Energy would be glad to elaborate on our experiences and our ideas, perhaps in meetings with representatives of the FTC, and we appreciate the opportunity to provide these comments.

What incentives do suppliers have to maintain adequate reserve capacity?

Reserve Capacity Is Necessary to Ensure Reliability

Electricity must be available with a very high degree of reliability to sustain our ways of life and business in the United States. This availability relies, in large part, on the ability to produce electricity to match demand as it varies from moment to moment. In many industries, suppliers handle short-term variations in demand for their products by increasing or decreasing inventories, but there is no way to store electricity effectively once it is produced. Instead of inventorying electricity, the electric industry meets fluctuating demand by building flexible generating units. In effect, the electric industry's inventory is in its generators. If the inventory is too low and demand spikes and exceeds supply, customers must be turned away through interruptions to preserve the stability of the entire system.

Complicating the supply situation is the fact that generators are not always available when they are needed. Scheduled maintenance can make generators unavailable for months at a time, and equipment failures can halt electricity production without warning. At the same time, demand for electricity is hard to predict because it depends so much on unpredictable weather. As a result, it is necessary to have a surplus of generators to increase the probability that there will always be enough supply even if the weather is extreme and several generators are unavailable. It is difficult to determine the amount of reserve generation capability that is appropriate to assure reliability, but numbers between 15% and 20% appear frequently in the industry.

Can Market Forces Ensure Adequate Reserves?

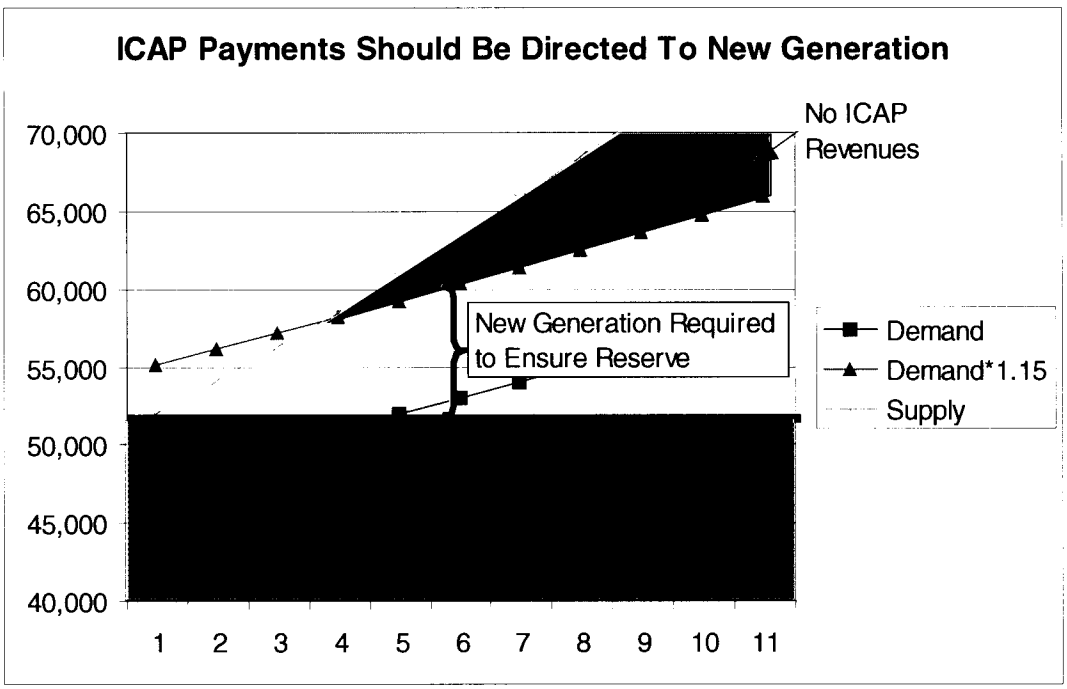
As the electricity industry environment transitions from monopoly to competition, the industry faces a relatively new challenge of determining how to stimulate the development of enough new generation to guarantee that there will be sufficient reserve to assure reliability. California's disaster is cited as evidence that the market may react too slowly to avoid supply shortages. Although the environment in California may not be typical of other U.S. regions, the severity of California's shortage has made most policy- makers uncomfortable about relying on market forces alone to ensure supply will always be adequate.

Before introducing competition to electricity markets, regulators forced utilities to maintain 10-year supply plans to ensure that supplies would be adequate. In some cases, these regulatory methods still resulted in supply shortages, and in others, supplies exceeded demand

by as much as 50%. In recent decades, however, there was never a supply shortage approaching the shortage that California currently faces. As a result, policymakers are looking to the other regions that have re-regulated to introduce retail competition. The tight power pools in the Northeast require Load Serving Entities ("LSE") to have surplus generating capacity. If an LSE owns no generation, these tight pools (now Independent System Operators) allow them to purchase Installed Capacity ("ICAP") Credits from others that have more than they need to satisfy the ISO's reserve generation capability.

ICAP Is Currently Expensive

ICAP is designed to provide a steady revenue stream to help cover the fixed costs of owning a generator, and these payments, in theory, encourage developers to build new generation. Unfortunately, most of the ICAP payments go to existing generators instead of going to developers of new generation. As a result, at today's prices for ICAP credits, customers in the Northeast pay between $4,000 and $6,000 per kilowatt of incremental generating capacity in ICAP payments over five years, yet at most 5% of the total collected goes to the developers of new generation. If developers can sell all of the ICAP credits from their new generators, then they might receive $200 to $300 per kW in their most optimistic projections, but would probably receive less. However, these revenues are diluted if excess ICAP credits are available, and predicting if excess ICAP credits will be available a few years in the future is practically as difficult as predicting the weather. This is why most generators discount ICAP revenues significantly in their financial evaluations. ICAP revenues are so uncertain that many developers discount ICAP revenues to zero.



Directed ICAP

If all of the payments for ICAP went directly to the new generators, they would receive $4,000 to $6,000 per kilowatt, which would provide plenty of incentive to build new generation. In fact, this is far too much incentive. $300/kW is quite sufficient incentive to encourage new development, and, if implemented, ICAP payments, which are ultimately paid by end-use customers, could be reduced considerably. The ISOs could provide this incentive of $300 per kilowatt by charging a Directed ICAP charge to all Load Serving Entities of 0.1 cent/kWh. Customers in NY City currently pay 1.8 cents/kWh for ICAP, on average.

The new generator would receive its incentive after each year of commercial operation for the first five years, and new generation that exceeds the reserve generation capability requirement would not be eligible to receive Directed ICAP payments until the reserve generation capability requirement in megawatts increases because of increased demand. Once eligible, the new generation could only receive Directed ICAP payments for its first five years of operation. For example, if a generator came on line but wasn't required to meet reserve requirements for its first two years of commercial operation and became eligible in its third year, then it would receive Directed ICAP payments for its third, fourth and fifth year of operation. This way, generators are not encouraged to build excessive surplus generation.

Energy Policy Implications

Directed ICAP would give policymakers the opportunity to adjust the incentive payment to new generators in order to encourage fuel diversity, renewable generation and conservation. For example, if everyone is building gas-fired peaking plants, policy makers might reduce their incentive to $100/kW and increase the incentive to build renewable generation to $500/kW. Directed ICAP could also be used to encourage demand response programs that benefit reliability by reducing demand instead of increasing supply.

More Effective, Lower Cost, and Additional Policy Benefits

Generators would be able to count on Directed ICAP payments much more than they can currently count on receiving ICAP revenues, and the cost to customers is much lower. Reliability is enhanced because this greater certainty leads to more development, and policy makers can encourage the kind of development that they prefer to see. Without getting into the difficulties from which ICAP markets have suffered, Directed ICAP is potentially a much simpler solution. Many details of Directed ICAP must be worked out before it can be implemented, but the concept really isn't very complicated. If regulators, politicians and other policy makers are truly interested in reliability, work to implement Directed ICAP should begin immediately for the Northeast ISOs, and probably for the California ISO as well.

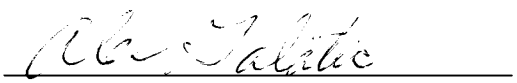
It is also important for all of the other regions around the United States to consider implementing Directed ICAP before the current implementations of ICAP in the Northeast, which are very expensive and arguably ineffective, become entrenched and start to spread. PJM, for example, has very good solutions for energy markets, and it is now offering its solutions broadly in an attempt to develop standard wholesale electricity markets. PJM's offer includes its ICAP market solutions. If Directed ICAP can be implemented in PJM and in the ISO New England, which is searching frantically for a capacity solution, then the current ICAP market

will only exist in New York. If New York implements Directed ICAP, its customers will save, on average, about 15% of what they currently pay for electricity supply.

Respectfully submitted,

Strategic Energy L.L.C.

Alex Galatic



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April 3, 2001